Sunderland City Council

Item No. 9

AUDIT AND GOVERNANCE COMMITTEE **20 July 2018**

TREASURY MANAGEMENT – FIRST QUARTERLY REVIEW 2018/2019

Report of the Head of Financial Management

1. Purpose of Report

1.1 To report on the Treasury Management (TM) performance to date for the first quarter of 2018/2019.

2. Description of Decision (Recommendations)

2.1 The Committee is requested to:

- Note the positive Treasury Management performance during Quarter 1 of 2018/2019.
- Note the Lending List Criteria at Appendix B and the Approved Lending List at Appendix C.

3. Introduction

3.1 This report sets out the Treasury Management performance to date for the first quarter of the financial year 2018/2019, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

4. Summary of Treasury Management Performance for 2018/2019 – Quarter 1

4.1 The Council's Treasury Management function continues to look at ways to maximise financial savings and increase investment return to the revenue budget. PWLB rates continue to be volatile, in part linked to uncertainty over the outcome of Brexit negotiations. No new borrowing has been taken out to date during 2018/19 but the position continues to be monitored closely.

4.2 One option to make savings is through debt rescheduling; however no rescheduling has been possible in 2018/2019 as rates have not been considered sufficiently favourable. It should be noted the Council's interest rate on borrowing is very low, currently 3.21%, and as such the Council benefits from this lower cost of borrowing and also from the ongoing savings from past debt rescheduling exercises. Based on advice from the Council's treasury advisor, performance continues to see the Council's rate of borrowing compare favourably to other authorities.

4.3 Treasury Management Prudential Indicators are regularly reviewed and the Council is within the limits set for all of its TM Prudential Indicators. The statutory limit under section 3 (1) of the Local Government Act 2003, which is required to be reported separately, (also known as the Authorised Borrowing Limit for External Debt) was set at £584.123m for 2018/2019. The Council's maximum external debt during the financial year to 30th June 2018 was £396.136m and is well within this limit. More details of all of the TM Prudential Indicators are set out in section A2 of Appendix A for information.

4.4 The Council's investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions which will benefit the Council.

4.5 As at 30th June 2018, the funds managed by the Council's Treasury Management team have achieved a rate of return on its investments of 0.78% compared with the benchmark 7 Day LIBID (London Interbank Bid) rate of 0.36%. Performance is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Council, in what remains a very challenging market.

The rate of return on investments has remained at the very low levels seen in previous years although there has been some upward movement since the increase in the base rate to 0.50% announced by the Bank of England at its Monetary Policy Committee meeting on 2nd November 2017. Special tranche investment rates (which offer better than market average returns) have risen slightly since the increase to the base rate and interest rates are continuously monitored so that the Council can take advantage.

4.6 More detailed Treasury Management information is included in Appendix A for Members' information.

4.7 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings since the last report. The updated Approved Lending List is shown in Appendix C for information.

5. Recommendation

5.1 Members are requested to note the Treasury Management (TM) performance for the first quarter of 2018/2019.

5.2 Members are requested to note the Lending List Criteria at Appendix B and the Approved Lending List at Appendix C.

Appendix A

Detailed Treasury Management Performance – Quarter 1 2018/2019

A1 Borrowing Strategy and Performance – 2018/19

A1.1 The Borrowing Strategy for 2018/2019 was reported to Cabinet on 7th February 2018 and approved by full Council on 7th March 2018.

The Borrowing Strategy is based upon interest rate forecasts from a wide cross section of City institutions. The view in February 2018, when the Treasury Management Policy and Strategy was drafted, was that following the first increase in the Bank of England (BoE) Base Rate since July 2007 from 0.25% to 0.50% there would be further increases of 0.25% by the end of 2018, 2019 and late summer 2020. PWLB borrowing rates were expected to rise, albeit gently, during 2018/2019 across all periods but could be subject to exceptional levels of volatility due to uncertainty over the outcome of Brexit negotiations and geopolitical developments throughout the world.

The Bank of England's (BoE) Monetary Policy Committee voted at its meeting on 11th May to leave rates unchanged following weak growth figures in the first quarter of 2018. Evidence of growth picking up during the second quarter are reflected in markets pricing in a better than 50% chance of an August rate hike. The BoE May 2018 Inflation Report revised the 2018 growth forecast to 1.5% in 2018 (from 1.6% in the February Report) with further forecasts remaining unchanged at 1.6% in 2019 and 1.7% in 2020. CPI inflation is expected to return to the 2% target over the two-year period on the basis of a 0.50% increase in the Bank Rate over the same timeframe.

Link Asset Service, the Council's economic advisors report that whilst the economy has shown signs of regaining momentum, the uncertainty around Brexit negotiations, consumer spending levels and business investment mean it is still far too early to be confident about how strong growth and inflationary pressures will be over the next two years and consequently the pace of any rate increases. Adding to these pressures is the increasing likelihood of a trade war as the USA implements protectionist policies. They forecast a rise in the Bank Rate of 0.25% to 0.75% by December 2018 with a further rise to 1.00% by September 2019.

Link Asset Services predict a gradual rise in PWLB rates is likely with rates reaching 2.10%, 2.60%, 3.00% and 2.70% for 5, 10, 25 and 50 year durations by 31st March 2019. High levels of volatility in PWLB rates and bond yields are expected to continue during 2018. The volatility is highly correlated to geo-political events and sovereign debt crisis developments and continued uncertainty over what form of Brexit will emerge.

The following table shows the average PWLB rates for Quarter 1 to date.

2018/2019	**Qtr 1* (Apr - June) %**
7 days notice	0.36
1 year	1.44*
5 year	1.86*
10 year	2.29*
25 year	2.66*
50 year	2.40*

*rates take account of the 0.2% discount to PWLB rates available to eligible authorities that came into effect on 1st November 2012.

A1.2 The strategy for 2018/2019 is to adopt a pragmatic and flexible approach in identifying the low points in the interest rate cycle at which to borrow, and to respond to any changing circumstances to seek to secure benefit for the Council. A benchmark financing rate of 3.50% for long-term borrowing was set for 2018/2019 in light of the views prevalent at the time the Treasury Management policy was set in March 2018. Due to high levels of volatility in the financial markets, with borrowing rates still forecast to remain low over the short term, no new borrowing has been undertaken in the current financial year up to 30th June 2018, but the Treasury Management team continues to closely monitor PWLB to assess the value of possible further new borrowing in line with future Capita Programme requirements.

A1.3 The Borrowing Strategy for 2018/2019 made provision for debt rescheduling but due to the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long-term debt, it would be difficult to refinance long-term loans at interest rates lower than those already in place.

Rates have not been sufficiently favourable for rescheduling in 2018/2019 so far and the Treasury Management team will continue to monitor market conditions and secure early redemption if appropriate opportunities should arise.

The Council successfully applied to access PWLB loans at a discount of 0.20%. This 'certainty rate' is available for those authorities that provide "improved information and transparency on their locally determined long-term borrowing and associated capital spending plans". The discount came into effect on 1st November 2012 and the Council has been successful in extending its access to the PWLB certainty rate until at least 31st October 2018.

A1.4 The Council's treasury portfolio position at 30th June 2018 is set out below:

		Principal (£m)	Total (£m)	Average Rate (%)
Borrowing				
Fixed Rate Funding	PWLB	238.7		
	Market	39.6		
	Other	6.7	285.0	3.48
Variable Rate Funding	Temporary / Other		27.6	0.41
Total Borrowing			**312.6**	**3.21**

A2 Treasury Management Prudential Indicators – 2018/2019

A2.1 All external borrowing and investments undertaken in 2018/2019 have been subject to the monitoring requirements of the Prudential Code. Under the Code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must also report on the Council's performance for all of the other TM Prudential Indicators.

A2.2 In December 2017 the Chartered Institute of Public Finance and Accountancy issued a revised Treasury Management Code and Cross Sectoral Guidance Notes and a revised Prudential Code. In addition the Ministry of Housing, Communities and Local Government are consulting on changes to the Guidance on Local Government

Investments and to the Statutory Guidance on Minimum Revenue Provision although the anticipated date of 1st April 2018 for the changes to take effect has slipped. A particular focus of these revised codes is how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the authority at a higher level than can be achieved by treasury investments. Changes to the CIPFA code and proposed changes to the MHCLG Guidance on Investments are considered within the Treasury Management Strategy and any further implications to the Council of these new codes will be reported once the final version has been published.

A2.3 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Council for 2018/2019 as follows:

	£m
Borrowing	505.092
Other Long-Term Liabilities	79.031
Total	**584.123**

The Operational Boundary for External Debt was set as shown below:-

	£m
Borrowing	480.092
Other Long Term Liabilities	79.031
Total	**559.123**

The Council's maximum external debt in respect of 2018/2019 (to 30th June 2018) was £396.136m and is well within the limits set by both of these key indicators.

A2.4 The table below shows that all other Treasury Management Prudential Indicators have been complied with:

Prudential Indicators		**2018/2019 (to 30/06/18)**	
		Limit £'000	**Actual £'000**
P9	**Upper limit for fixed interest rate exposure**		
	Net principal re fixed rate borrowing / investments	350,000	250,087
P10	**Upper limit for variable rate exposure**		
	Net principal re variable rate borrowing / investments	58,000	-30,995
P11	**Maturity Pattern**	Upper Limit	
	Under 12 months	50%	10.63%
	12 months and within 24 months	60%	2.06%
	24 months and within 5 years	80%	5.81%
	5 years plus	100%	82.96%
	A lower limit of 0% for all periods		
P12	**Upper limit for total principal sums invested for over 364 days**	75,000	0

A3 Investment Strategy – 2018/2019

A3.1 The Investment Strategy for 2018/2019 was approved by Council on 1st March 2017. The general policy objective for the Council is the prudent investment of its treasury balances. The Council's investment priorities in order of importance are:

(A) The **security** of capital;
(B) The **liquidity** of its investments and then;
(C) The Council aims to achieve the **optimum yield** on its investments but this is commensurate with the proper levels of security and liquidity.

A3.2 As at 30th June 2018, the funds managed by the Council's in-house team amounted to £156.415 million and all investments complied with the Annual Investment Strategy. This includes monies invested on behalf of all other external organisations. The table below shows the return received on these investments compared with the benchmark 7 Day LIBID (London Interbank Bid) rate, which the Council uses to assess its performance.

	2018/2019 Actual to 30/06/18 %	**2018/2019 Benchmark to 30/06/18 %**
Return on investments	0.78	0.36

A3.3 Investments placed in 2018/2019 have been made in accordance with the approved investment strategy and comply with the Counterparty Criteria in place, shown in Appendix B, which is used to identify organisations on the Approved Lending List.

A3.4 The investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions to the Council's advantage. New European Financial Directives known as MiFID II came into force on 3rd January 2018 which impact on the Councils investment policy. These directives are designed to strengthen transparency and investor protection in financial markets across the EU. Under the directives each client is classed as either retail or professional. Financial Institutions dealing with a number of regulated products including direct investments such as Certificates of Deposit, Gilts, Corporate Bonds and investment funds (including Money Market Funds) will only be able to deal with professional clients. All Local Authorities will be classified as de facto retail counterparties under MiFID II but with the option to ask to opt up to professional status subject to meeting qualitative and quantitative criteria. The Council has successfully met this criteria and has opted up to professional client status where appropriate.

A3.5 Investment rates available in the market remain lower than those achieved in previous years, although there has been some upward movement since the Bank of England announced the 0.25% increase in the base rate to 0.50% at its Monetary Policy Committee meeting on 2nd November, the first rate rise since July 2007.

A3.6 Due to the continuing high volatility within the financial markets, particularly in the Eurozone, advice from our Treasury Management advisers is to continue to restrict investments with all financial institutions to shorter term periods.

A3.7 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk, mainly where the government holds shares in these organisations (i.e. RBS) and therefore have the UK Government rating applied to them, or separately in respect of Money Market Funds which are AAA rated.

A3.8 The regular updating of the Council's authorised Lending List is required to take into account financial institution mergers and changes in institutions' credit ratings. The Approved Lending List is shown in Appendix C.

Counterparty Criteria

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisers.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

Fitch / S&P's Long Term Rating	Fitch Short Term Rating	S&P's Short Term Rating	Moody's Long Term Rating	Moody's Short Term Rating	Maximum Deposit £m	Maximum Duration
AAA	F1+	A1+	Aaa	P-1	120	2 Years
AA+	F1+	A1+	Aa1	P-1	100	2 Years
AA	F1+	A1+	Aa2	P-1	80	2 Years
AA-	F1+ / F1	A1+ / A-1	Aa3	P-1	75	2 Years
A+	F1	A-1	A1	P-1	70	364 days
A	F1 / F2	A-1 / A-2	A2	P-1 / P-2	65	364 days
A-	F1 / F2	A-2	A3	P-1 / P-2	50	364 days
Local Authorities (limit for each local authority)					30	2 years
UK Government (including debt management office, gilts and treasury bills)					350	2 years
Money Market Funds Maximum amount to be invested in Money Market Funds is £120m with a maximum of £50m in any one fund.					120	Liquid Deposits
Local Authority controlled companies (# duration limited to 20 years in accordance with Capital Regulations)					20	# 20 years

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AA will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above. These new limits are as follows:

Country Limit
It is proposed that only non-UK countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £100m which can be invested in other countries provided they meet the above criteria. A separate limit of £350m will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

Country	Limit £m
UK	350
Non-UK	100

Sector Limit
The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

Sector	Limit £m
Central Government	350
Local Government	350
UK Banks	350
Money Market Funds	120
UK Building Societies	100
Foreign Banks	100

Group Limit
Where institutions are part of a group of companies e.g. Lloyds Banking Group and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the UK continues to have a sovereign credit rating of AA; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix C.

Approved Lending List **Appendix C**

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
UK	AA	-	Aa2	-	AA	-	350	2 years
Lloyds Banking Group							**Group Limit 70**	
Lloyds Bank Plc	A+	F1	Aa3	P-1	**A+**	A-1	**70**	364 days
Bank of Scotland Plc	A+	F1	Aa3	P-1	**A+**	A-1	**70**	364 days
Royal Bank of Scotland Group (See Note 1)							**Group Limit 80**	
Royal Bank of Scotland Group plc	BBB+	F2	Baa3	P-3	BBB-	A-3	80	2 years
The Royal Bank of Scotland Plc	**A-**	F2	**A1**	P-1	**A-**	A-2	80	2 years
National Westminster Bank Plc	**A-**	F2	**A1**	P-1	**A-**	A-2	80	2 years
Santander UK plc	A	F1	Aa3	P-1	A	A-1	65	364 days
Barclays Bank plc	A	F1	A1	P-1	A	A-1	65	364 days
Clydesdale Bank *	BBB+	F2	Baa1	P-2	BBB+	A-2	0	
Co-Operative Bank Plc	B-	B	Caa2	NP	-	-	0	
Goldman Sachs International Bank	A	F1	A1	P-1	A+	A-1	65	364 days
HSBC Bank plc	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Nationwide BS	**A**	F1	Aa3	P-1	A	A-1	65	364 days
Standard Chartered Bank	A+	F1	A1	P-1	A	A-1	65	364 days
Top Building Societies (by asset value)								
Nationwide BS (see above)								
Coventry BS	A	F1	A2	P-1	-	-	65	364 days
Leeds BS	A-	F1	A3	P-2	-	-	50	364 days
Nottingham BS **	-	-	Baa1	P-2	-	-	0	
Principality BS **	BBB+	F2	Baa2	P-2	-	-	0	
Skipton BS **	A-	F1	Baa1	P-2	-	-	0	
West Bromwich BS **	-	-	**Ba3**	NP	-	-	0	
Yorkshire BS **	A-	F1	A3	P-2	-	-	50	364 days

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Money Market Funds							120	Liquid
Prime Rate Stirling Liquidity	AAA				AAA		50	Liquid
Insight Liquidity Fund	AAA		-		AAA		50	Liquid
Standard Life Investments Liquidity Fund	AAA		-		AAA		50	Liquid
Deutsche Managed Sterling Fund	AAA		Aaa		AAA		50	Liquid
Foreign Banks have a combined total limit of £100m								
Australia	AAA		Aaa		AAA		100	2 years
Australia and New Zealand Banking Group Ltd	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Commonwealth Bank of Australia	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
National Australia Bank	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Westpac Banking Corporation	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Canada	AAA		Aaa		AAA		100	2 years
Bank of Nova Scotia	AA-	F1+	A1	P-1	A+	A-1	70	364 days
Royal Bank of Canada	AA	F1+	A1	P-1	AA-	A-1+	70	364 days
Toronto Dominion Bank	AA-	F1+	Aa2	P-1	AA-	A-1+	75	2 years
Finland	AA+		Aa1		AA+		100	2 years
OP Corporate Bank plc	-	-	Aa3	P-1	AA-	A-1+	75	2 years
Germany	AAA		Aaa		AAA		100	2 years
DZ Bank AG (Deutsche Zentral-Genossenschaftsbank)	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Landwirtschaftliche Rentenbank	AAA	F1+	Aaa	P-1	AAA	A-1+	100	2 years
NRW Bank	AAA	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Netherlands	AAA		Aaa		AAA		100	2 years
Bank Nederlandse Gemeenten	AA+	F1+	Aaa	P-1	AAA	A-1+	100	2 years
Cooperatieve Centrale Raiffeisen Boerenleenbank BA (Rabobank Nederland)	AA-	F1+	**Aa3**	P-1	A+	A-1	70	364 days

	Fitch		Moody's		Standard & Poor's			
	L Term	S Term	L Term	S Term	L Term	S Term	Limit £m	Max Deposit Period
Nederlandse Waterschapsbank N.V	-	-	Aaa	P-1	AAA	A-1+	100	2 years
Singapore	AAA		Aaa		AAA		100	2 years
DBS Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Oversea Chinese Banking Corporation Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
United Overseas Bank Ltd	AA-	F1+	Aa1	P-1	AA-	A-1+	75	2 years
Sweden	AAA		Aaa		AAA		100	2 years
Nordea Bank AB	AA-	F1+	Aa3	P-1	AA-	A-1+	75	2 years
Svenska Handelsbanken AB	AA	F1+	Aa2	P-1	AA-	A-1+	75	2 years
USA	AAA		Aaa		AA+		100	2 years
Bank of New York Mellon	AA	F1+	Aa1	P-1	AA-	A-1+	75	2 years
JP Morgan Chase Bank NA	**AA**	F1+	Aa2	P-1	A+	A-1	70	364 days
Wells Fargo Bank NA	AA-	F1+	Aa1	P-1	**A+**	**A-1**	**70**	**364 days**

Notes

Note 1 — **Nationalised / Part Nationalised**
The counterparties in this section will have the UK Government's AA rating applied to them thus giving them a credit limit of £80m.

* — The Clydesdale Bank (under the UK section) is owned by National Australia Bank

** — These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the Prudential Regulation Authority (PRA) is classed as a UK bank for the purposes of the Approved Lending List.